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Taxation of Individuals

Chartered Accountancy
Strategic Level
Corporate Taxation (TAX)

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5. TAXATION OF INDIVIDUALS

An individual will be liable to pay income tax on his taxable income from the following sources;

1. Employment Income
2. Business Income
3. Investment Income
4. Other Income

Resident status

In determining the tax liability of an individual it is important to determine if such person is a resident or non resident of Sri Lanka.

An individual will be considered to be a resident in Sri Lanka for a year of assessment if the individual;

(a) Resides in Sri Lanka;
(b) Is present in Sri Lanka during the year and that presence falls within a period or periods amounting in aggregate to one hundred and eighty three days or more in any twelve month period that commences or ends during the year;
(c) Is an employee or an official of the Government of Sri Lanka and his spouse is posted abroad during the year; or
(d) Is an individual who is employed on a Sri Lanka ship, within the meaning of the Merchant Shipping Act, during the period the individual is so employed.

Illustration

Mr. A, was physically present in Sri Lanka for 150 days between 1 April 20x1 to 31st March 20x2. When considering the period between 1 August 20x1 to 31st July 20x2 he was present in Sri Lanka for 210 days.

Is he considered to be a resident of Sri Lanka for income tax purposes?

A resident individual will be liable to pay income tax on his "global income" wherever arising, whereas a non resident person will only be required to pay income tax on income arising in or derived from Sri Lanka.

Tax rates

Tax rates for resident and non-resident individuals after January 1, 2020

Taxable Income for a year of assessment	Tax Payable
Not exceeding Rs. 3,000,000/-	6% of the amount in excess of Rs. 0
Exceeding Rs. 3,000,000 but not exceeding Rs. 6,000,000	Rs. 180,000 plus 12% of the amount in excess of Rs. 3,000,000
Exceeding Rs. 6,000,000	Rs. 540,000 plus 18% of the amount in excess of Rs. 6,000,0000

Accounting for income tax

An individual must account for income tax purposes on **cash basis** when computing the income from the following sources;

(a) Employment
(b) Investment

An individual or entity conducting business shall account for income tax purposes on an **accrual basis**.

Capital Gain – Exemptions

(a) A gain made by a resident individual from the realization of an investment asset that does not exceed Rs. 50,000 and where the total gains made by the resident individual from the realization of investment assets in the year of assessment do not exceed Rs. 600,000/-. Where the asset is jointly owned, the exemption will be available if the total gain made by all owners does not exceed Rs. 50,000 and the total gains for the year of assessment does not exceed Rs. 600,000.
(b) A gain made by a resident individual on the realization of the individual's principal place of residence, provided it has been owned by the individual continuously for the 3 years before being realized and lived in by the individual for at least two of those three years.

Qualifying payments and reliefs

An individual has the following reliefs for a year of assessment as specified in the Fifth schedule to the IRA;

- Rs. 3,000,000 for each year of assessment. This is not available to be deducted against gains from the realization of investment assets.
- In the case of an individual with rental income from an investment asset, an amount equal to 25% of the total rental income for the year of assessment being a relief for the repair, maintenance and depreciation relating to the

investment asset. However, no deduction or cost can be claimed for any actual expenditure incurred by the taxpayer for the repair , maintenance and deprecation of the investment asset.

- Upto Rs. 1,200,000 for each year of assessment on;
    1. Health expenditure including contributions to medical insurance
    2. Vocational education or other educational expenditure incurred locally by such individual or on behalf of such individual's children
    3. Interest paid on housing loans
    4. Contributions made to any local pension scheme, other than for a scheme under the employer or on behalf of the employer, by an employee
    5. Expenditure incurred for the purchase of shares or any other financial instrument listed in the Colombo Stock Exchange and licensed by the Securities and Exchange Commission of Sri Lanka or treasury bonds
- Rs. 600,000 for each year of assessment for a resident who has acquired solar panels to fix on his premises and connected to the national grid, upto the total expenditure on such solar panels or upto the amounts paid to a bank in respect of any loan obtained to acquire such solar panels.

5.1.INCOME FROM EMPLOYMENT

A person employed in a company receiving a salary, it is considered to be part of profits from employment. However, a person working as a consultant in a professional capacity, is not considered to be profits from employment.

Income from employment can be distinguished from the other sources on the basis of certain characteristics of employment income. The characteristics are as follows;

- Presence of employer employee relationship
- Presence of an employment service contract. All amounts received under the contract of employment service are income from employment.
- Presence of payment for services rendered, This is the conclusive test, Amounts received for employment services are employment income irrespective of whether received from the employer or not.

Illustration
An individual has joined a company who provides services in the capacity of a Finance Controller. The company has provided him with an appointment letter. He also acts as a consultant to a sister company in the group. Determine whether any income received by him in this arrangement is profit from employment.

Categories of Profits from Employment

The Act identifies the following categories of profits from employment.

i. Cash benefits
ii. Reimbursement of expenses
iii. Agreement to conditions of employment
iv. Payments for loss of employment
v. Retirement contributions
vi. Payment to any other person for the benefit of the employee
vii. Non cash benefits
viii. Other payments including gifts
ix. Share benefits
x. Retirement benefit

Cash benefits

The following payments received by an employee has been considered as income from employment –

- salary, wages, leave pay, overtime pay, fee, pensions, commissions, gratuities, bonuses and other similar payments
- personal allowance, including cost of living, subsistence, rent, entertainment or travel allowance

Reimbursement of expenses

Any discharge or reimbursement of expenses which has been paid for by the individual or an associate of the individual will be considered as income from employment. However, any expenses which the employee incurs on behalf of the employer, which is subsequently reimbursed by the employer will not be considered to be income from employment.

A discharge or reimbursement of the employee's dental, medical or health insurance expenses where the benefit is available to all full-time employees on equal terms will not be included as employment income. These benefits must be available to all employees and must be provided without discrimination. As the term used here is "equal terms" and not "equal amount" it means that the conditions on which the employees are entitled to such benefits should be the same.

Associate of the individual will include a "relative" of such individual. The term "relative" has been defined as the individual's child, spouse, parent, grandparent, grandchild, sibling, aunt, uncle, nephew, niece, first cousin, including by way of marriage or adoption.

Agreement to conditions of employment

This will be payments made by an employer to an employee which mandated that the employer must adhere to certain conditions imposed by the employer. This will include payments made to an employee to refrain from joining a competitor, not to disclose proprietary information of the employer etc.

Payments for loss of employment

This will include any payment made by the employer for redundancy or loss or termination fo employment. For example, payments made during retrenchment, compensation paid for termination of employment etc.

Retirement contributions

Any retirement contributions made to a retirements fund on behalf of the employee and the retirement payments received by the employee have both been considered to be income from employment. However, certain contributions made by an employer to an employee's account with a pension, provident or savings fund or savings society approved by the Commissioner General will be excluded from the calculation of employment income, subject to conditions which will be specified by the Commissioner General. As such , these payments will only be liable to income tax at the time the employee receives such contributions.

Payment to any other person for the benefit of the employee of his associate

Where the employer makes a payment to a third party on behalf of the employee will be considered as employment income. For example, payment of rent for a house which is being used by the employee, payment for an airline ticket which is used by the employee for personal travel etc.

Non cash benefits

Any benefits such as vehicle provided by the employer, meals provided by employer etc will be considered to be income from employment and will be liable to tax at the fair market value of the benefits. These benefits should be received or derived by virtue of the employment. The benefits may be enjoyed by the individual or an associate person of the individual.

Other payments including gifts

Any gifts which are received by the employer will be considered to be income from employment. For example, gift vouchers granted by the employer will be liable to income tax. Where there is a link between the payment and the employment and that the payment would not have been made but for the employment, that gift would be considered as a gift received in respect of employees. Below are a few examples of gifts;

- Tips – Employees in certain industries receive tips from their employer or a third party as reward for services rendered in the course of the employment. Such tips will be taxable.
- Awards – An employer may award prizes according to an incentive scheme to the employees for the efficient performance of their work. Such payments are taxable.
- Appreciation - Gifts given to employees that are used to show appreciation are taxable.

Any payments which are made to or benefits accruing to employees on a non-discriminatory basis that, by reason of their size, type and frequency, are unreasonable or administratively impracticable for the employer to account for or to allocate to the individual will not be included when computing the employment income.

For example, a cup of tea/meals provided to all employees, bus services provided by the employer, annual staff parties and trips, recreational and sports facilities available to all employees, parking facilities will not be liable for income tax as employment income.

Share benefits

The market value of any shares allotted to an employee under a share option scheme, including shares allotted as a result of the exercise of an option or right to acquire the shares, will be considered to the income from employment. However, any contribution made by the employee to acquire such shares can be reduced when computing the benefit which is taxable in the hands of the employee.

The benefit will be calculated as income from employment at the time the shares are allotted in to the name of the employee. However, the value of a right or option to acquire shares will not be considered income from employment at the time such right or option is granted to the employee.

Exemptions for employment income

The following amounts which are exempt from income tax should be excluded when calculating employment income of an individual;

- Capital sums paid to a person as compensation or gratuity in relation to –
    - Personal injuries suffered by the person; or

    - The death of another person.
- The pension of a person where the pension income is paid by the Government of Sri Lanka or a department of the Government of Sri Lanka
- An amount paid to an employee at the time of retirement from –
    - Any pension fund or the Employees Trust Fund established by the Employees Trust Fund Act, No. 46 of 1980, as represents income derived by that fund, for any period commencing on or after April 1, 1987, from investments made by it;
    - A provident fund approved by the Commissioner- General

Calculating employment income

Income from all the above sources other than exempt sources and final withholding payments will be aggregated in arriving at the assessable income from employment. No deductions can be made in arriving at the assessable income from employment.

Retirement benefits

The following retirement benefits will be taxed at a concessionary rate;

(a) Amount received in commutation of a pension
(b) Amount received as a retiring gratuity
(c) Amount received as compensation for loss of office or employment under a scheme which the Commissioner – General considers to be uniformly applicable to all individuals employed by the employer
(d) Amount paid to a person at or after the time of retirement from employment from a provident fund approved by the Commissioner-General that does not represent the person's contributions to that provident fund
(e) Amount paid to a person from a regulated provident fund that does not represent the contributions made by the employer to that provident fund before April 1, 1968, and the interest which accrued on such contributions made by the employer, if tax has been paid by the employer at 15% on such contributions made and the interest accruing thereon
(f) Amount paid to a person at or after the time of retirement from the employment from the Employees' Trust Fund, established by the Employees' Trust Fund Act, No. 46 of 1980.

The amount of tax to be paid on the income from the above sources are to be calculated as follows;

Total income from Employment	Tax payable
Not exceeding Rs. 10,000,000	0% of the amount in excess of Rs. 0
Exceeding Rs. 10,000,000 but not exceeding Rs. 20,000,000	6% of the amount in excess of Rs. 10,000,000
Exceeding Rs. 20,000,000	Rs. 600,000 plus 12% of the amount in excess of Rs. 20,000,000

Source of payments

The following payments received in respect of employment will be considered to have a source in Sri Lanka;

(a) To the extent derived in respect of employment in Sri Lanka, wherever paid; or

(b) If paid by, or on behalf of, the Government of Sri Lanka, wherever the employment is

Where an individual has income from employment with a source in Sri Lanka as well as employment income that has a foreign source, each of such income sources should be calculated separately. When computing the employment income from a foreign source, such income will be considered to be such person's global income and any income from employment with a source in Sri Lanka on that employment can be deducted.

Obligation of employer to withhold tax on employment – Advance Personal Income Tax (APIT)

An employer must deduct Advance Personal Income Tax (APIT) with effect from April 1, 2020 on any employment income paid to employees if such employee;

- Is a non-resident or non-citizen of Sri Lanka or
- Is a resident and citizen of Sri Lanka who gives his consent.

The tax rates at which the employer should withhold taxes from an employee is to be specified by the Commissioner General and published by Gazette.

A withholding tax certificate must be issued by the employer to the employee for each year of assessment, and it should cover the period during the year in which he was employed. These certificates are to be issued on or before 30th of April after each year of assessment, and where an employee has ceased employment, the certificate should be issued within 30 days from the date on which the employment ceased.

5.2.ALTERNATIVE COMPUTATION METHODS

5.2.1. Net Wealth method

Proving Income

To prove unreported income, the government could use the net wealth method, which is an indirect method. The net wealth method relies on circumstantial evidence to show increases in net worth that do not match an individual's reported income.

Net Wealth Method

The theory of the net wealth method is that if an individual has more wealth at the end of a given year than at the beginning of that year, and the increase is not from non-taxable sources such as a gift, loan, or inheritance, then the amount of the increase is taxable income for that year.

If it chooses to use the net wealth method, the government must perform an in-depth financial investigation. Essentially, the investigation and resulting calculation portrays the financial life of an individual, both prior to and during the tax year(s) in question. Because the government is approximating the individual's income using circumstantial evidence, there are specific requirements in the net wealth method of proof to ensure the government's evidence is adequately dependable to prove beyond a reasonable doubt that the individual had unreported taxable income.

The government proves a *prima facie* case under the net wealth method if it establishes the individual's opening net wealth with reasonable certainty and then shows increases in the net wealth each year in question, which adding non-deductible expenditures and excluding known non-taxable receipts for the year, exceed reported taxable income by a substantial amount.

Basic Steps in a Net Wealth Method

The following are the basic steps necessary in a net worth method case:
1. Establish net wealth at the end of the taxable year with reasonable certainty.
2. Establish net wealth at the beginning of the same taxable year, which is then subtracted from the end of year taxable net wealth.
3. Add non-deductible expenditures.
4. Subtract non-taxable receipts from income sources.
5. Compare that figure with the amount of taxable income reported by the individual to determine the amount, if any, of underreporting.

Books and Records

The net wealth method is frequently used when it would be difficult or impossible to establish an individual's taxable income by direct evidence. Such as in the case where an individual intentionally fails to keep books and records documenting income and expenses. Or, when an individual's books and records are inadequate or false. While the books and records are helpful, they are not crucial to the net wealth method of proof.

Requirements for Proving Net Wealth

In utilizing the net wealth method, the government must:

1. Determine an opening net wealth for the year in question with reasonable certainty,
2. Determine an individual's net wealth at the close of the year in question, with any amount over the opening net wealth being the net wealth increase,
3. Determine a likely source of taxable income or refute non-taxable sources of income, and
4. Investigate reasonable and timely leads given by the individual as to possible non-taxable sources of income, et cetera.

Opening Net Wealth

Net wealth increases are established through comparing an individual's opening net wealth against the individual's net wealth at the close of the same year. March 31 of the year just prior to the tax year in question, is the starting point in determining the opening net wealth.

For example: If the government is investigating an individual's year of assessment 2018/19, they will utilize the individual's March 31, 2018 figure for their opening net wealth calculation.

Thorough Investigation

The government must conduct a thorough investigation, with supporting evidence, to meet the threshold of "reasonable certainty" of the opening net wealth figure. The government's investigation will include, but not be limited to, confirmation from financial institutions for records including possible loans, checks of local real estate records for purchase/sale/ownership, checks of local probate records for inheritance, and interviews of witnesses.

Evidence Establishing Opening Net Wealth

The opening net wealth figure must include all of the individual's assets that are reasonably determined including assets resulting from non-taxable sources of funds such as gifts, loans, and inheritances, and assets resulting from taxable income. It is important to identify assets acquired in the years prior to the year in question, both for a correct opening net wealth figure and as possible basis of funds to acquire assets in the year in question.

For example: If an individual received an inheritance of Rs. 150 Mn in 2017 and the government, in its investigation of the individual's tax year of assessment 2018/19, failed to discover the Rs. 150 Mn inheritance received during the prior year, the government's opening net wealth will be understated. If the individual utilized the Rs. 150 Mn inheritance to purchase real property in 2018, the net wealth calculation would incorrectly attribute this net wealth increase to the individual's 2018/19 year of assessment. The net effect of the error would be to overstate the individual's taxable income by Rs. 150 Mn in 2018/19.

The government will utilize prior income tax returns and financial statements the individual has submitted to the IRD and/or financial institutions as starting points for their opening net wealth calculations.

Cash in Hand

The opening cash balance is frequently challenged in net wealth cases. Although cash on hand includes currency an individual carries on their person, it also encompasses all cash readily available to the individual that is not deposited in a bank or other financial institution, such as:

- in a safe deposit box,
- in a safe in the home/office, and/or
- hidden in/on the individual's property.

One defense involving a large opening cash balance is referred to as the cash hoard. In such cases, individuals assert that in years prior to the year in question, they accumulated funds over many/several years through cash gifts from family/friends or an inheritance, et cetera, which they then spent during the year in question.

In disproving the existence of a cash hoard, the government may show the individual's actions are inconsistent with an individual who had access to large sums of cash, such as:

- taking out high interest loans,
- borrowing nominal amounts from family/friends to pay bills,
- incurring bank charges for bounced cheques,
- buying household items on credit or installment payments, or
- making ATM cash withdrawals in small amounts.

The government will also ask very detailed questions of the individual about a cash hoard, including:

- What was the source(s) of the funds?
- Where were the funds kept?
- Were they always kept in the same location?
- Who else was aware of the funds?

If an asset was acquired with cash during the year in question and cannot be traced to withdrawal from a bank account, then the government must provide evidence to negate a cash hoard.

If an individual reports they received a loan or inheritance from a relative or friend as a basis for unexplained income, the government may review the tax filing history or construct a simple net wealth of the family member/friend in their investigation of the accuracy of the individual's assertion.

Net Wealth Assets

Generally, when determining an individual's net wealth, assets are reflected at cost, not fair market value. Assets preexisting the year in question are a source of non-taxable funds only to the extent of their basis.

For example: If an individual purchases a home in 2008 for Rs. 200 Mn and in the year of assessment 2018/19 under investigation it increased in value to Rs. 350 Mn the home is reflected as a net wealth asset of Rs. 200 Mn because the net wealth method considers actual costs and expenditures.

Across the Board Assets

An asset the individual owned in the opening year and continued to own throughout the years in question, with no decrease or increase in cost, is considered an across the board asset. Because an across the board asset does not change the net wealth calculation, the government may choose to leave that asset out of its calculations.

For example: If an individual purchased stock in the amount of Rs. 380,000 two years prior to the three years in question, and maintained the stock throughout the three years in question. This would be an across the board asset as the cost basis remained the same.

On occasion, the government will utilize a "-" in their schedule to reflect cash on hand amount that is assumed to remain constant during the year(s) in question.

Bank Accounts/Nominee Accounts
Funds in bank accounts, after reconciliation of outstanding cheques and deposited items, are reflected as assets in the net wealth calculation. The government will also look for bank accounts an individual may have opened in the name of family or friends.

Assets/Liabilities of Spouse or Children

The assets and liabilities of an individual's spouse and children will be reviewed to determine if they should be included in the net wealth calculation, or whether amounts are *de minimus*.

Partnership Interest

An individual's share of the partnership capital is an asset.

Liabilities

The government must produce evidence of an individual's liabilities with reasonable certainty. The liabilities are then subtracted from assets to arrive at an individual's net wealth.

Non-Deductible Expenditures

The net wealth increase is established after subtracting the ending net wealth from the opening net wealth. The increase is then adjusted by adding an individual's non-deductible expenditures for the year in question, including living expenses and other items not reflected as assets.

It is the government's burden to prove, through independent documentary or testimonial evidence, that expenditures added to the net wealth increase are non-deductible expenditures, rather than deductible expenses. Non-deductible expenditures made on behalf of the individual's spouse or children will be added to the net wealth increase.

Examples of non-deductible expenditures that will be added to the net wealth increase include:

- food,
- clothing,
- household supplies,
- gifts,
- vacation,
- entertainment, or
- household help.

If the government is not able to establish exact living expenses, the jury can conclude that the individual had necessary living expenses beyond what the government proved.

Reductions in Net Wealth

The reason for the net wealth calculation is to determine an individual's taxable income. Therefore, the government must take care to deduct non-taxable items received by the individual in the year in question.

Non-taxable receipts include:

- Inheritances,
- Tax-exempt income,

Attributing Net Wealth increases to Taxable Income

The government will either prove the likely source of the taxable income or negate sources of non-taxable income when establishing net wealth increases are the result of currently taxable income.

The government can use direct or circumstantial evidence to support the likely source of taxable income. An individual's investments in real estate, ownership in a joint venture, ownership of stocks and bonds, and ownership of a business can demonstrate likely sources of unreported taxable income.

5.2.2. Receipts and payments method

A receipts and payments account is a summary of actual cash receipts and payments extracted from the cash book over a certain period. All cash received and paid during the period whether capital or revenue is included in this account.

Net wealth method

The Net wealth method of determining taxable income is based upon the theory that any increases or decreases in the taxpayer's wealth during a taxable period adjusted for non-taxable expenditure and non-taxable income must have been the result of taxable income or loss. This can be simple expressed by the formula;

"What your have"

(less) what you began with

Plus "What you used and lost = "What you received"

The net wealth computation is generally targeted to fine the undisclosed income from trade, business, profession or vocation.

When we consider the reference to any group of assets, both terms mentioned above refers only to your portion of those assets. Others portion or others interest to those assets should be removed. Therefore;

"What you begin with" = Assets – Liabilities = net wealth at the beginning of the period

"What you have" = Assets – Liabilities = net wealth at the end of the period

The regular net wealth computation consists of preparing Assets and Liability sheets for the beginning and end of each year involved. Asset values should be listed at cost in all cases. If the taxpayer reports and it permitted by law to report on the market value basis the values should be converted into cost basis.

"What you used and lost" should be added to this increase or decrease in net wealth.

"What you used and lost"

1. Personal living expenses
2. Income tax payments
3. Donation and gifts given

The result is equal to "what you received". What you received represents the total income and gains. Then the income and gain's total should be broken down into sources.

Sources are –

- Profits from trade, business, profession or vocation
- Employment income
- Dividends, interest or discounts
- Charges and annuities
- Rents, royalties or premiums
- Winning from lottery, betting or gaming
- Casual and non recurring receipts
- Gifts received
- Inheritances
- Capital Gains
- Proceeds on life and other personal insurance policies

Analysing the entire scenario the undisclosed income of each source should be identified separately. Generally these sources can be categorized into two groups as taxable sources and non taxable sources.

Finally, the losses, damages and wastages are to be analysed in terms whether allowable in taxation.

The taxpayer's net wealth – the difference between his assets and liabilities – is determined at the beginning of the year. The taxpayer's net wealth is then established at the end of the year and the yearly increases and decreases are then determined. Then adjustments are made to each of these yearly increases or decreases in net wealth for uses, losses and non-taxable items.

The net wealth method is an excellent method to be employed when the accounts from which the profit and loss computation is to be made have been found to be false, incomplete or missing. Even when the wealth survey should indicate the correctness of the profit and loss statement, with special emphasis on the accuracy and verification of the gross receipts portion of the Return.

As was previously mentioned a set of records, which may appear to eb adequate from first observation may be inadequate due to items of omission. Therefore, if at the beginning of an examination, even though the records may appear to be adequate, it may be advisable for a tax consultant to prepare a rough net wealth analysis.

The statement should be checked carefully for inaccuracies and omissions. Such a net wealth statement, as part of the records relating to the taxpayer, would always be available as a starting point for any future income verification.

The opening net wealth statement

The opening net wealth furnished by the taxpayer should be subject to proper scrutiny. Each item of the net wealth may be verified as to the date of acquisition. The following items deserve special consideration;

1. Immovable Property

A reference to the title deeds may not only help to check the correctness of the date of acquisition of wealth but also to see whether the property was paid for in cash or was not subject to any mortgage. In case of properties recently constructed, it may be good to verify whether the construction was completed before the date of opening net wealth or after.

2. Cash

The taxpayer may claim a large opening cash balance which may not be real. Fact relating to the following circumstances may usually be relevant;

a. If the taxpayer a person who is not likely to use modern banking facilities
b. Does he have a bank account? If so, what is his explanation for keeping it in cash at home
c. Is he an investor? Has he advanced any moneys to any person on interest or saved in call deposits? If so, what is his explanation for not similarly investing these moneys?
d. Has he borrowed any money from anybody else? Has he made any claim for deduction of interest from his income for income tax purposes? If so, what is his explanation for borrowing the same on interest when he has idle cash at home?

One of the most important factors in a net wealth computation is the establishment of a correct and "tight" opening net wealth statement. This usually involves the sound determination of cash in hand in the opening net wealth. In many cases the taxpayer, will make claims sizeable cash accumulations at the beginning of the period in an attempt to counteract the increase determined by this method of computation.

Template for computing net wealth

Mr. ……………………………….
Computation of Net Wealth/Total Income and Gains for the year ended ……………..

	Starting date of the period	**Closing date of the period**
Immovable Property	xxxx	xxxx
Movable Property	xxxx	xxxx
Debtors	xxxx	xxxx
Total Assets	**xxxx**	**xxxx**
Less : Liabilities	(xxxx)	(xxxx)
Net Wealth	**xxxx**	**xxxx**
Less: Opening Wealth		(xxxx)
Increase/Decrease in Net Wealth		**xxxx**
Add : Uses and losses		xxxx
Personal Expenditure		xxxx
Gifts and Donations given		xxxx
Total Income & Gains		**xxxx**

Break up of the Total Income & Gains

Source	**Amount**	**Adjusted value for taxation**
Remuneration from Employment		
Income from Trade/Business/Profession/Vocation		
Investment Income (dividends, interest, discounts, charges, annuities, natural resource payments, rents, premiums, royalties, earning amounts as winnings from a lottery, reward, betting or gambling) + Gain from the realization of Investment Assets (Capital Gain)		
Others		
Gifts received		Not taxable
Inheritances		Not taxable
Profits of a casual and non-recurring nature		Not taxable

EXERCISES

1. Mr, Nishantha Wijesooriya is engaged in a small scale money lending business. He has not prepared financials accounts for his business. The following information has been given by him with regard to his assets and liabilities.

	31.03.2020	**31.03.2021**
House (at cost)	6,000,000	8,000,000
Lands (at cost)	3,000,000	10,000,000
Motor Vehicles (at cost)	4,000,000	7,500,000
Jewellery (at cost)	2,000,000	3,500,000
Loans given	20,000,000	18,000,000
Cash in Hand	2,000,000	2,500,000
Loans taken	2,000,000	4,000,000

Additional Information

a. He married on 12th July 2020 and his father in law has given him Rs. 2,000,000/- as a gift.
b. He has agreed his personal expenses (including cost of living) as Rs. 2,500,000/-
c. He assured he has no any other income or source of funds except those mentioned above.

You are required to calculate his income from business for the year of assessment 2020/21.

Receipts & Disbursement method

This method is a variation of the net worth method and is simply the comparison of all known receipts of funds with all known disbursement of funds.

First the opening and closing cash in hand and bank current account balances (including debit/credit card) should be accounted appropriately. Then, fund inflows to the person has to be identified as receipts while fund outflows from the person as disbursements. Thus, the sale proceeds of assets are receipts whereas the acquisitions are the same as disbursements. Proceeds received through the liabilities are considered as receipts while payments made to discharge the liabilities are treated as disbursements. All personal uses and losses of funds are considered as disbursements.

Next, the fund inflows from all income sources are accounted as receipts. At this point due consideration should be given to take only withdrawals of funds from the balance sheet (drawings) as receipts if the individual has given financial statements including a balance sheet for his income from trade/business/profession/vocation.

Another frequent issue arises in preparation of receipts and disbursements account is the accounting of acquisition and disposal of an asset in the same year of assessment or creation and discharge of liability in the same year of assessment. In the asset case the acquisition should be treated as a fund disbursement while the disposal as a fund inflow. In case of the liability the trigger of liability should be accounted as a fund inflow while the discharge as a fund outflow.

Template for Receipts and Disbursements Account

Mr. ………………………….
Receipts and Disbursement Account for the year ended 31.03…………………

Receipts		**Disbursements**	
Opening Balance (Cash/Bank)	Xxx	Acquisition/Improvement of Assets	xxx
Disposal of Assets	Xxx	Redemption/Discharge of liabilities	Xxx
Proceeds received from liabilities	Xxx	Uses and losses of funds	Xxx
Source of Income and Funds Salary Business Income Drawings from business Investment Income Gifts and Donations received in Funds	 Xxx Xxx Xxx Xxx Xxx		
		Closing Balance (Cash/Bank)	Xxx
	Xxx		**xxx**

CHAPTER REVIEW EXERCISES

Question 1

Gamini, is a resident individual who is an Attorney at Law by profession. He works as the legal officer of a finance company in Sri Lanka. The following information is available regarding his income for the year of assessment 2021/22 (hereinafter referred to as the 'year'):

(1) Income from Employment:

- Gross salary - Rs.325,000/- per month.
- Travelling allowance - Rs.50,000/- per month.
- Bonus received in April 2020 from the profits of previous year was Rs.300,000
- In May 2020, he was sent to India to represent the company in an international seminar. The cost of the tour which was reimbursed by the company was Rs.120,000/-.
- He lives in a rented house and monthly rent of Rs.35,000/- is reimbursed by the employer.
- APIT deducted for the year was Rs.604,800/-.

(2) Gamini started his own business of consultancy on 01st April 2021. The summary of the income and expenditure account prepared for the year ended 31st March 2022 is as follows:

	Rs.		Rs.
Salaries to staff	225,000	Income	2,844,000
Electricity and water bills	27,000		
Depreciation	126,000		
Other expenses	143,000		
Net Profit	2,323,000		
	2,844,000		2,844,000

- Office Equipment of Rs.400,000/- has been purchased for the business in January 2022. There are no other qualifying assets on which capital allowances could be claimed.
- All other expenses are allowable for tax purposes.

(3) Gamini lives in a rented house in Colombo. His own house is in Ratnapura and it was rented out to a family for a monthly rent of Rs.25,000/-.
(4) Gamini had a fixed deposit in a commercial bank and interest for the year on

this deposit was Rs.132,000/-. The bank has deducted withholding tax on interest.
(5) Gamini purchased shares of a quoted public company on 01st July 2018 at a cost of Rs. 5 million. He sold these shares in May 2021 for Rs. 6 million. He has received a net dividend of Rs.243,000/- in April 2021.
(6) During the year, Gamini has donated equipment worth of Rs.500,000/- to Ministry of Health.
(7) Gamini has paid Rs.100,000/- as installment payments of income tax for the year of assessment 2021/22.

You are required to:
Assess the following for Gamini for the year of assessment 2021/22:
(a) Taxable income.
(b) Gross income tax payable.
(c) Balance tax payable.
(d) Exempt income, if any.

Question 2

Rangana is a Chartered Accountant, who works as the Chief Financial Officer of Double Q (Pvt) Ltd a leading apparel manufacturing company in Sri Lanka. The following information relating to Rangana is provided in respect of the Y/A 2021/22.

1. Income from employment
    a. Gross salary: Rs. 600,000 per month.
    b. The company has provided him a motor car (engine capacity: 1700cc) along with fuel.
    c. Under the Employment Share Option Plan, an option had been given to Rangana to purchase 10,000 shares at Rs. 60 per share whereas the market value of a share is Rs. 120. He exercised this option during this Y/A.
    d. Rs. 420,000 had been reimbursed by the company on foreign visits made by Rangana to meet a business partner in Singapore.
    e. Contribution made by the employer to a provident fund which is a fund approved by the Commissioner General of Inland Revenue was Rs. 300,000.
    f. The employer had deducted Rs. 256,000 as APIT for the Y/A.
    g. Rangana had also been appointed as a director of a subsidiary company of Double Q (Pvt) Ltd, which had paid him a director's fee of Rs. 22,500 (net of tax) per month. The company had issued the T10 certificate relating to the tax deducted by the company.

2. Income from business

In addition to his employment, Rangana provides investment advisory services to both local and foreign customers as an independent investment advisor. The draft income statement prepared for the year ended 31 March 2022 is given below.

	Rs.
Revenue - consultancy fees	5,465,000
Less: expenses Salaries and wages	(2,850,000)
Stationery	(167,000)
Entertainment expenses	(120,000)
Donation	(175,000)
Income tax instalment payments	(150,000)
Foreign travelling	(135,000)
Other expenses	(924,500)
Net profit	943,500

a. During the Y/A he earned USD 900 in foreign currency from Maldives and this amount had been included in the revenue. (USD 1 = LKR 200).
b. Cash donation of Rs. 175,000 was made to "National Kidney Fund".
c. He had paid Rs. 150,000 as income tax instalment payments for the Y/A 2021/22.
d. During the Y/A, Rangana visited Maldives to meet some prospective clients. The cost of the tour is included under foreign travelling.
e. In June 2021, Rangana purchased furniture for his office amounting to Rs. 450,000. No depreciation has been recognised in the income statement with respect to this.
f. Other expenses include a penalty paid to the Department of Inland Revenue for delay in making tax payments amounting to Rs. 5,400. All other expenses were incurred in the production of income.

3. Income from investments
   a. Rangana purchased a luxury house situated in Wadduwa and it had been rented out to a company to be operated as a holiday resort. Monthly rent was Rs. 140,000 and the tenant bears the rates of Rs. 75,000.
   b. He had earned Rs. 404,500 as interest income during the Y/A on a fixed deposit in a bank. No tax was deducted.
   c. During the Y/A, Rangana sold the shares of AB PLC, a listed company at a profit of Rs. 56,000.

Required:

Compute the income tax liability, tax credits and balance tax payable/receivable by Rangana for the Y/A 2021/22.